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IN THE

Supreme Court of the United States

October Term, 1975

No. 75-96

COLONIAL REALTY CORPORATION,
Petitioner,

against

JOHN MacWILLIAMS, JR., JAMES E. BRENNAN
and COLONIAL PENN GROUP, INC.,
Respondents.

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

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July 16, 1975

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IN THE

Supreme Court of the United States

October Term, 1975

No.

COLONIAL REALTY CORPORATION,

Petitioner,

against

JOHN MACWILLIAMS, JR., JAMES E. BRENNAN and COLONIAL PENN GROUP, INC.,

Respondents.

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

In this action to recover insiders' short-swing profits under § 16(b) of the Securities Exchange Act of 1934 (the "Act"), petitioner Colonial Realty Corporation, plaintiff-appellant below, prays this Court for a writ of certiorari to review the judgment of the Second Circuit entered March 20, 1975.

Opinions Below

The opinions of the Second Circuit (Appendix A, p. 1a below) and of the District Court for Southern New York (Appendix C, p. 4a below) are reported, respectively, at 512 F. 2d 1187 and 381 F. Supp. 26.

Jurisdiction

The judgment of the Second Circuit (Appendix B, p. 3a below) was dated and entered March 20, 1975. By order of June 6, 1975 (Appendix D, p. 7a below), this Court, Mr. Justice Marshall, extended the time for filing a petition for certiorari to and including July 17, 1975. The jurisdiction of this Court is invoked under 28 USC § 1254(1).

The jurisdiction of the District Court rested on § 27 of the Act.

Question Presented

Is a corporate officer liable under § 16(b) of the Securities Exchange Act for his profits derived from selling his company's stock and repurchasing it six months minus a day later?

Statutes and Regulations Involved

The relevant text of § 16(b) of the Act and of certain SEC regulations appears in Appendix E, p. 8a below.

Statement of the Case

The complaint alleges that petitioner is a stockholder of defendant Colonial Penn Group, Inc. (the "Corporation"). Defendants MacWilliams and Brennan ("defendants") are officers of the Corporation. Each of them, it is alleged, sold shares of the Corporation's common stock (registered under § 12 of the Act) and repurchased all or part thereof, at a profit, six months minus a day after the sale.*

* MacWilliams sold 50,000 shares on December 20, 1972 and purchased 45,000 shares on June 19, 1973. Brennan sold 4,000 shares on December 22, 1972 and purchased 5,000 shares on June 21, 1973.

Following a futile demand that the Corporation sue defendants for their profits, petitioner brought this action on behalf of the Corporation. Defendants moved, without affidavit, to dismiss the complaint for failure to state a claim, on the theory that their transactions did not occur within the statutory period of "less than six months". The District Court (Gurfein, J.) indicated that it might have denied the motion had it approached the problem in the first instance (6a); but it felt "constrained" by *stare decisis* (*ibid.*) to dismiss the complaint in accordance with the rule announced in *Stella* v. *Graham-Paige Motors Corp.*, 132 F. Supp.. 100, 103-104 (S.D.N.Y. 1955), *remanded*, 232 F. 2d 299 (2d Cir.), *cert. denied*, 352 U.S. 831 (1956). The Second Circuit affirmed Judge Gurfein's decision upon his opinion and upon Chief Judge Kaufman's brief remarks from the bench.

The decisions below, following the District Court in *Stella*, would reduce the statutory holding period to six months minus two days. Petitioner contends that it is six months; but even if it be one day less, defendants are liable.

Reasons for Granting the Writ

The Court of Appeals did not just purport to decide an isolated, individual controversy. It deliberately issued its opinion "[i]n order to afford our decision precedential value * * * and conclusively to resolve this question within our circuit" (2a). Unless reviewed by this Court, the decision below will thus effectively become the law of the land and will henceforth determine the interpretation of the six-month clause of the statute. Review by this Court is needed not only to correct the error of the decision below in interpreting an important provision of the securities

laws, but because the improper way in which the Court below approached and resolved the issue calls for the exercise of this Court's supervisory power.

I.

The Court below has so far departed from the accepted and usual course of judicial proceedings as to call for an exercise of this Court's power of supervision.

This case presented the Court below with a clearcut, novel and serious question of statutory interpretation. No previous appellate court had undertaken to resolve it. Nevertheless, the Court below did not even attempt to find the correct answer. It did not try to interpret the language of the statute. It did not seek to determine the intention of Congress in an area of grave national concern. It ignored the legislative materials. It passed in silence over familiar principles governing the computation of time. It did not devote a word to the expressions of this Court, of other courts and of the SEC, which might have given it guidance. The fact—hard to believe but demonstrable—is that the Court below thought a legally correct result was unnecessary.

Significantly, Judge Gurfein had stated that, as a matter of first impression, he might well have sustained the complaint (6a). By adopting his opinion, the Court of Appeals agreed with this statement. It recognized, therefore, that the correct interpretation of the statute presents, to say the least, a serious question.

But neither the Court of Appeals nor the District Court purported to find an answer to that question. As noted, Judge Gurfein in the District Court felt "constrained" by *stare decisis* to adopt the *Stella* rule (6a). Whether

or not he was right, certainly the Court of Appeals was under no such constraint. *Stella* was only a District Court decision, and dictum at that; its interpretation of the six-month clause of the statute was neither affirmed nor approved on appeal.* It is elementary that a district court decision cannot operate as *stare decisis* on a court of appeals—just as a lower court decision cannot bind this Court as *stare decisis*. *United States* v. *Byrum*, 408 U.S. 125, 134 (1972); *Calaf* v. *Gonzalez*, 127 F. 2d 934, 938 (1st Cir. 1942). After all, it is the very purpose of appellate tribunals to review and, if necessary, correct the legal views of lower courts, not to be bound by them. By blandly following the District Court's dictum in *Stella* without determining whether or not it was correct, the Court below fell grievously short in the performance of its tasks as an appellate court.

None of the grounds advanced by the Court of Appeals in support of *stare decisis* (2a) has substance. In the first place, we are told that the *Stella* principle—

> "has not proved unworkable or difficult to apply, nor does it do any violence to the central purpose of the securities law, since the six-month requirement it implements is essentially an arbitrary legislative guidepost." (2a)

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* The *Stella* insiders purchased their stock on February 10, 1947 and resold it on and before August 7 (132 F. Supp. at 106). It made, therefore, no difference whether the statutory period was a full six months or two days less, for even on the latter view, the last day of the period was August 8 (*ibid.*). *Stella's* excursion into statutory interpretation was thus gratuitous and pure dictum.

Nor was the District Court's dictum approved on the *Stella* appeal. Judge Frank agreed, of course, that "sales made before August 8, 1947 [i.e. the sales actually made] were within the statutory period" (232 F.2d at 301; interpolation added); but he did not imply that later sales, e.g. on August 8, 9 or 10, would have been immune. Indeed, even on the District Court's view, a sale on August 8 would have been within the statute (132 F. Supp. at 105).

Of course, all statutory time limitations are "arbitrary" —the statute of limitations, the time to appeal, and countless others. If a lower court were to rule that the appeal period is 31 days, a higher court would correct the error even though the statutory 30 days are "arbitrary" and 31 days might be equally "workable". If *Stella's* computation of the 16(b) holding period was in error, its perpetuation by the Court of Appeals is not excused because Congress might have chosen a different period that might also have been workable. The choice of the proper period was for Congress, not for the Court below or for the District Court in *Stella*. Whether or not the choice made by Congress goes to "the central purpose" of the securities laws, is of no moment. In either case it was the duty of the Court of Appeals to ascertain and effectuate the Congressional intent, not to brush it aside as unimportant. That duty was the more insistent since public policy requires the strict enforcement of § 16(b).*

The statement below that *Stella* "has been followed for almost two decades" (2a) is simply wrong; except for a single dictum, the *Stella* principle has never before been followed.** The inevitable citations of *Stella* by a number of legal writers (2a) did not relieve the Court below of its responsibility to undertake its own critical evaluation of the statute.

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* Section 16(b) is "remedial" and "must be strictly construed" against the profiting insider so as "to squeeze all possible profits out of [his] stock transactions". *Adler* v. *Klawans*, 267 F. 2d 840, 846-47 (2d Cir. 1959, by Judge, now Chief Justice, Burger); *Smolowe* v. *Delendo Corp.*, 136 F. 2d 231, 239 (2d Cir.), *cert denied*, 320 U.S. 751 (1943). Both cases were cited with approval in *Reliance Electric Co.* v. *Emerson Electric Co.*, 404 U.S. 418, 422 (1972).

** The dictum is in a footnote to *Rheem Manufacturing Co.* v. *Rheem*, 295 F. 2d 473, 475, n. 3 (9th Cir. 1961). The Court there dismissed a 16(b) claim not because the statutory six-month holding period had run, but because the defendant had acquired the securities "in good faith in connection with a debt previously contracted."

Finally, the Court of Appeals suggested that defendants should not be "penalized for patterning their transactions after the formulation announced in *Stella*" (2a). The record does not contain the slightest hint that defendants relied on *Stella*; but it would make no difference if they did. An insider foolhardy enough to engage in a two-day gamble on no firmer ground than the single district court dictum in *Stella* is not entitled to protection; he is "deemed capable of structuring his dealings to avoid any possibility of taint and therefore must bear the risks of any inadvertent miscalculation", *Champion Home Builders Co.* v. *Jeffress*, 490 F. 2d 611, 619 (6th Cir.), *cert. denied*, 416 U.S. 986 (1974). But even if defendants could claim some sympathy, it would afford no ground to perpetuate an erroneous interpretation of the statute for all times to come.

The Court below has elevated a single district court dictum to become the law of the land. In doing so, it did not give even passing consideration to the merits of the statutory question before it. The Court thus abdicated its responsibilities as an appellate tribunal. Its procedure, we submit, urgently calls for review by this Court.

II.

The decision below, cutting two days from the statutory six-month period, is contrary to the context of § 16(b), its legislative history, and all pertinent authorities.

The importance of the question

Section 16(b) is an integral part of a comprehensive statutory scheme designed to protect the securities markets from manipulation and deceit; *Senate Committee on Banking and Currency*, S.R. 792, 73rd Cong., 2d Sess. (1934),

p. 6. The six-month provisions of § 16(b) is the cornerstone of the legislative plan. Even at the common law, a corporation's fiduciary had to surrender any profits he derived from the abuse of inside information, *Diamond* v. *Oreamuno*, 24 N.Y. 2d 494, 248 N.E. 2d 910, 301 N.Y.S. 2d 78 (1969); but the extreme difficulty of proving the actual use of inside information rendered the common law rule ineffective. Congress dispensed, therefore, with the proof of subjective factors and based liability simply upon the period of time between the insider's purchase and sale of securities. It was the judgment of Congress that an insider making a short-swing trade was so likely to be acting on inside information that his liability should be conclusively presumed.* The fixing by Congress of the period as six months was thus a crucial policy decision entitled to strict judicial enforcement. Since the decision below would undermine the congressional policy, it should be reviewed by this Court.

The language and interpretation of the statute

It is elementary that a time period running from a specified event is computed by excluding the day of the event and by including the last day of the period. *Burnet* v. *Willingham L. & T. Co.*, 282 U.S. 437, 439 (1931, Holmes, J.); *Sheets* v. *Selden's Lessee*, 2 Wall. (69 U.S.) 177, 190 (1865).** In *Stella*, however, Judge Dimock turned the rule on its head: He included the day of the initial securities transaction in the statutory six months; he excluded the last day of the six months; and in this fashion cut two days

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* See, e.g., *Petteys* v. *Butler*, 367 F. 2d 528, 532 (8th Cir. 1966), *cert. denied*, 385 U.S. 1006 (1967); *Blau* v. *Max Factor & Co.*, 342 F. 2d 304, 308 (9th Cir.), *cert. denied*, 392 U.S. 892 (1965).

** The rule is embodied in § 31 of the Bankruptcy Act, 11 USC § 54, and in Rule 6(a) FRCP, and has been universally followed by the lower courts, e.g., *Becker* v. *C.I.R.*, 378 F.2d 767, 769 (3d Cir. 1967).

from the six months, one at the beginning and one at the end of the period (132 F. Supp. at 103-104). We submit that he erred on both counts.

The statute, to be sure, refers to a purchase and sale "within" less than six months; but the word "within" does not mean, as Judge Dimock thought, that the statutory holding period starts running even before the insider purchases any securities he can hold. It simply means that the purchase and sale, to be actionable, must be "within any period of less than six months from each other."* The statutory period thus starts only *after* the day of the original transaction, in accordance with the general principle in *Burnet, supra* (282 U.S. at 439), and *Sheets, supra* (69 U.S. at 190).

Nor does the reference of the statute to a period of "less than six months" mean, as Judge Dimock thought, that a full day must be lopped off at the end of the six months. Since the last day of the six months runs until midnight, a sale prior to midnight, i.e., during the course of the last day, is within "less than six months".**

The contrary view of *Stella* is in direct conflict with the statute. Section 16(b) provides that an insider's liability

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* This is how the Chairman and Special Counsel of the SEC read the provision. Cook and Feldman, *Insider Trading under the Securities Exchange Act*, 66 Harv. L. Rev. 385, 409 (1953): "these transactions must be within six months of each other".

** The principle that the law disregards fractions of a day, relied on by Judge Dimock, is beside the point. It is "a figurative recognition of the fact that people do not trouble themselves without reason about a nicer division of time" (*Burnet, supra*, 288 U.S. at 440). For 16(b) purposes, it is unnecessary to trouble oneself about the nice divisions of a day; for whether the ultimate securities sale occurs at 10 A.M. or 4 P.M. of the last day of the six months, it is within "less than six months" from the initial purchase. For similar reasons, a period of "more than 6 months" (see 26 USC § 1222) does not mean six months plus one day but six months plus any fraction of time however short. *Becker* v. *C.I.R., supra*, 378 F.2d at 769; Revenue Ruling 70-598, Cumul. Bull. 1970-2, p. 168.

shall be irrespective of his intention to hold the securities purchased "for a period exceeding six months". The clause clearly reflects the intent of Congress to impose liability unless the insider actually retains the securities purchased for more than six months.

But even if the statutory language were deemed ambiguous, the doubt would have to be resolved against the insider. As Judge (now Chief Justice) Burger held in *Adler* v. *Klawans*, 267 F.2d 840, 846-47 (2d Cir. 1959), section 16(b)—

> "is remedial, rather than penal, and * * * must be strictly construed in favor of the corporation and against any person who makes profit dealing in the corporation stock."

Legislative materials.

The legislative materials, although not extensive, all point in one direction.* Thomas Corcoran and Ferdinand Pecora were among the principal draftsmen of the Act (House Hearings 82-84; Senate Hearings 6463-65, 7703). Both men testified extensively. Mr. Pecora explained that an insider is permitted to profit from investments in his company—

> "provided his transactions are more than 6 months apart. * * * If he buys and does not sell again for another 6 months, he does not have to account." (Senate Hearings 7742).

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* As herein used, "House Hearings" refers to *Stock Exchange Regulation*, Hearing on H.R. 7852 and H.R. 8720 before the Committee on Interstate and Foreign Commerce, House of Representatives, 73d Cong., 2d Sess. (1934).

"Senate Hearings" refers to *Stock Exchange Practices*, Hearings on S. Res. 84 (72d Cong.), S. Res. 56 and 97 (73d Cong.) before the Committee on Banking and Currency, United States Senate, 73d Cong., 1st and 2d Sess. (1934).

In the same vein, Mr. Corcoran stated that § 15 of the bill (H.R. 7852, the precursor of the present § 16) forbade an insider to—

> "get in and out of stock within six months. If he does, the profit goes to his company." (House Hearings 133).

Both explanations made it clear that the holding period was to be six months; neither suggested a diminution of the period by one or two days. Similarly, the *Senate Committee Report*, S. Rep. 792, 73d Cong., 2d Sess. (1934), pp. 20-21, stated that the bill called for the surrender of insider profits—

> "derived from sales and purchases *within a period of 6 months or less.*" (Emphasis added)

Against this legislative background, it would seem clear that Congress intended the statute to provide for a full six months' holding period.

To ascribe a different purpose to Congress would be unnatural and opposed to common sense. Granting that the six-month requirement is "essentially arbitrary" (2a), how much more arbitrary would it be to provide a holding period of six months minus two days! A legislative body setting an arbitrary time will naturally choose a round figure. Six months is a round figure; and it is hard to conceive of any reason why Congress should have selected a period as odd and unusual as six months minus two days.

Judicial interpretation.

It is thus no wonder that this Court as well as others have time and again described the 16(b) period as comprising six months, not six months minus one or two days.

In *Kern County Land Co.* v. *Occidental Petroleum Corp.*, 411 U.S. 582, 595 (1973), this Court said that liability under § 16(b) attaches—

> "for any profits realized from any purchase and sale or sale and purchase of stock occurring within a period of six months."

Reliance Electric Co. v. *Emerson Electric Co.*, 404 U.S. 418, 422 (1972):

> "A person avoids [16(b)] liability • • • if he sells more than six months after purchase."

The lower courts have used similar language. Thus, *B.T. Babbitt, Inc.* v. *Lachner*, 332 F.2d 255, 258 (2d Cir. 1964), held that a purchase of shares on November 5, 1958 and a sale on May 6, 1959 "exceeded six months—if only by one day." And see, *e.g.*, *Petteys* v. *Butler*, 367 F.2d 528, 531 (8th Cir. 1966), *cert. denied*, 385 U.S. 1006 (1967) ("within six months after the date of purchase"); *Heli-Coil Corp.* v. *Webster*, 352 F.2d 156, 160 (3rd Cir. 1965) ("within a six-months' period"); *Booth* v. *Varian Associates*, 334 F.2d 1, 3 (1st Cir. 1964), *cert. denied*, 379 U.S. 961 (1965) ("within six months of the date of the purchase"). Indeed, in the very case at bar, the Court below referred to the "six-month requirement" of the statute (2a).

It may be true, as Judge Gurfein noted below (6a), that court and counsel in some of these cases did not give specific consideration to the issue here involved; but that is no ground to brush the cases aside. Coming from this Court and the Court of Appeals, repeated references to "six months" persuasively demonstrate that this is the natural and reasonable meaning of the statute, as it impresses itself on readers not given to the loose use of language. If that be true, it is a reasonable inference that the intent of Congress was the same.

Interpretation by the SEC.

In the construction of § 16(b), the views of the SEC, as the agency charged with the administration of the statute, are entitled to great deference; *Udall* v. *Tallman*, 380 U.S. 1, 16 (1965). The Commission clearly considers the applicable period to be six full months, not one or two days less.

SEC Rule 16b-6, 17 CFR 240.16b-6 (quoted p. 9a below) deals with insider profits arising from the exercise of stock options and a corresponding stock sale; the Rule is designed to hold the insider liable only for his short-swing profit, not for the long-term appreciation of the option. *Sec. Exch. Act Release No. 4509*, '48-'52 CCH Fed. Sec. L. Rep. ¶ 76,080 (1950). Significantly, the Rule defines the short-swing period as "within six months before or after the date of sale"; Rule 16b-6(b). The Commission thus treated the short-swing period as "a period of six full months ending at midnight on the day of sale"; *Morales* v. *Walt Disney Productions*, 361 F. Supp. 1157, 1158 (S.D.N.Y. 1973). The same view is repeatedly expressed in the Commission's Release, *supra*:

> "Accordingly, under Section 16(b) the insider who has *held his investment for six months* is free to realize what he can from selling it." (pp. 78,756-57; emphasis added).
>
> "* * * the critical period for measuring short-swing aspects of profit derived from the exercise of an option is the *six months after the sale.*" (p. 78,758; emphasis added).

Similarly, Rule 16a-1(e), 17 CFR 240.16a-1(e) (quoted p. 9a, below), deals with a director who buys securities while still in office but sells them after he ceases being a director; he must report the sale if it "shall occur within

six months after'' the purchase. Again, the Commission considers the applicable period to be six full months, not one or two days less. It can hardly be suggested that, in framing these Rules, the Commission failed to focus on the precise boundaries of the statutory period.

Conclusion

All relevant factors—the context of § 16(b), its reasonable meaning, its legislative history, and the great weight of its judicial and administrative interpretation—point to a statutory period of a full six months. The Court below did not disagree. Nevertheless, it cut two days from the six-month period, defeating the intent of Congress and presenting a gift of two days to faithless fiduciaries. By its uncritical adoption of *Stella*, it permitted a District Court dictum to become a controlling precedent without giving even passing consideration to the correct interpretation of the statute. In this offhand fashion, the congressionally intended protection of investors has been dealt a serious blow.

The petition for a writ of certiorari should be granted and the judgment below should be reversed.

Respectfully submitted,

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Dated: July 16, 1975

APPENDIX A

Opinion of the Court of Appeals

UNITED STATES COURT OF APPEALS
FOR THE SECOND CIRCUIT

No. 596—September Term, 1974.
(Argued March 20, 1975 Decided March 20, 1975.)
Filed March 21, 1975.)
Docket No. 74-2280

COLONIAL REALTY CORPORATION,
Plaintiff-Appellant,

v.

JOHN MACWILLIAMS, JR., JAMES E. BRENNAN and COLONIAL PENN GROUP, INC.,
Defendants-Appellees.

Before:

KAUFMAN, *Chief Judge,*
SMITH, *Circuit Judge,* and MACMAHON, *District Judge.**

Appeal by Colonial Realty Corporation, from a judgment by the United States District Court for the Southern District of New York, Murray I. Gurfein, *Judge,* dismissing shareholder's derivative action because the sales and repurchases did not occur within periods of less than six months for purposes of § 16(b) of the Securities Act of 1934, 15 U.S.C. § 78p(b).

Affirmed.

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* Of the Southern District of New York, sitting by designation.

WILLIAM E. HAUDEK, New York, New York (Pomerantz, Levy, Haudek & Block, New York, New York, on the brief; Richard M. Meyer, A. Arnold Gershon, New York, New York, of counsel), *for Appellant.*

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PER CURIAM:

This case was affirmed in open court. In order to afford our decision precedential value,[1] however, and conclusively to resolve this question within our circuit, we issue this brief per curiam. We affirm for the reasons stated in open court,[2] and in Judge Gurfein's opinion below, 381 F. Supp. 26 (S.D.N.Y. 1974).

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[1] Rule § 0.23 of the United States Court of Appeals for the Second Circuit provides in pertinent part:

> . . .
>
> Where a decision is rendered from the bench, the court may deliver a brief oral statement . . . Since these statements do not constitute formal opinions of the court and are unreported and not uniformly available to all parties, they shall not be cited or otherwise used in unrelated cases before this or any other court.

[2] The statement delivered from the bench was as follows:

> We agree with Judge Gurfein that the rule announced in *Stella* v. *Graham Paige*—that transactions occurring on January 1 and June 30 do not fall within the statutory period of "less than six months"—is dispositive of this case. That principle has not proved unworkable or difficult to apply, nor does it do any violence to the central purpose of the securities law, since the six-month requirement it implements is essentially an arbitrary legislative guidepost. Moreover, every legal research tool an investor might consult, from Professor Loss's treatise to Jennings and Marsh has cited *Stella* as controlling authority.
>
> Under these circumstances, we believe that the doctrine of *stare decisis* is the wise policy. We do not believe that the defendants should be penalized for patterning their transactions after the formulation, announced in *Stella*, which has been followed for almost two decades. Accordingly, we affirm.

APPENDIX B

Judgment of the Court of Appeals

UNITED STATES COURT OF APPEALS
FOR THE SECOND CIRCUIT

At a stated Term of the United States Court of Appeals for the Second Circuit, held at the United States Courthouse in the City of New York, on the twentieth day of March one thousand nine hundred and seventy-five.

Present:

HON. IRVING R. KAUFMAN, *Chief Judge.*
HON. J. JOSEPH SMITH, *Circuit Judge.*
HON. LLOYD F. MACMAHON, *District Judge.*

74-2280

—o—

COLONIAL REALTY CORPORATION,
Plaintiff-Appellant,

v.

JOHN MACWILLIAMS, JR., JAMES E. BRENNAN & COLONIAL PENN GROUP, INC.,
Defendants-Appellees.

—o—

Appeal from the United States District Court for the Southern District of New York.

This cause came on to be heard on the transcript of record from the United States District Court for the Southern District of New York, and was argued by counsel.

ON CONSIDERATION WHEREOF, it is now hereby ordered, adjudged, and decreed that the orders of said District Court be and they hereby are affirmed with costs to be taxed against the appellant.

A. DANIEL FUSARO
Clerk

By VINCENT A. CARLIN
Chief Deputy Clerk

COPY BOUND

Opinion of the District Court

COLONIAL REALTY CORPORATION, Plaintiff,

v.

John MacWILLIAMS, Jr., et al., Defendants.

No. 74 Civ. 1818.

United States District Court, S. D. New York.

Aug. 21, 1974.

1. Securities Regulation ⇐111

Sale of stock by one corporate officer on December 20 and purchase of shares in the corporation on the following June 19 and sale by second corporate officer on December 22 and purchase on the following June 21, did not constitute short-swing sales within a period of "less than six months." Securities Exchange Act of 1934, § 16(b), 15 U.S.C.A. § 78p(b).

See publication Words and Phrases for other judicial constructions and definitions.

2. Courts ⇐96(7)

Although stare decisis is not so rigid as to require perpetuation of error, decision that phrase "less than six months" as applied to short-swing stock transactions does not include the date of sale was not so clearly in error as to require reconsideration. Securities Exchange Act of 1934, § 16(b), 15 U.S.C.A. § 78p(b).

3. Courts ⇐96(7)

Absent a showing of significant unworkability or injustice, determination of method of computing six-month period set out in statute which prohibits the unfair use of information obtained by insiders on short-swing sales was one on which investors had a right to rely. Securities Exchange Act of 1934, § 16(b), 15 U.S.C.A. § 78p(b).

Shareholder's derivative action was brought against two corporate officers. On corporate officer's motion to dismiss, the District Court, Gurfein, J., held that sale of stock on December 20 and repurchase of stock on the following June 19th by one officer and sale on December 22nd and repurchase on June 21st by second officer did not occur within periods of less than six months for purposes of statute prohibiting unfair use of information obtained by insiders on short-swing sales.

Motion to dismiss granted.

Pomerantz Levy Haudek & Block, New York City, for plaintiff.

Paul, Weiss, Rifkind, Wharton & Garrison, New York City, for defendants.

GURFEIN, District Judge:

This is a shareholder's derivative action brought by plaintiff in the name of Colonial Realty Corporation (Colonial) against two officers of Colonial Penn Group, Inc. (CPG). The complaint alleges that defendants MacWilliams (chief executive officer and chairman of

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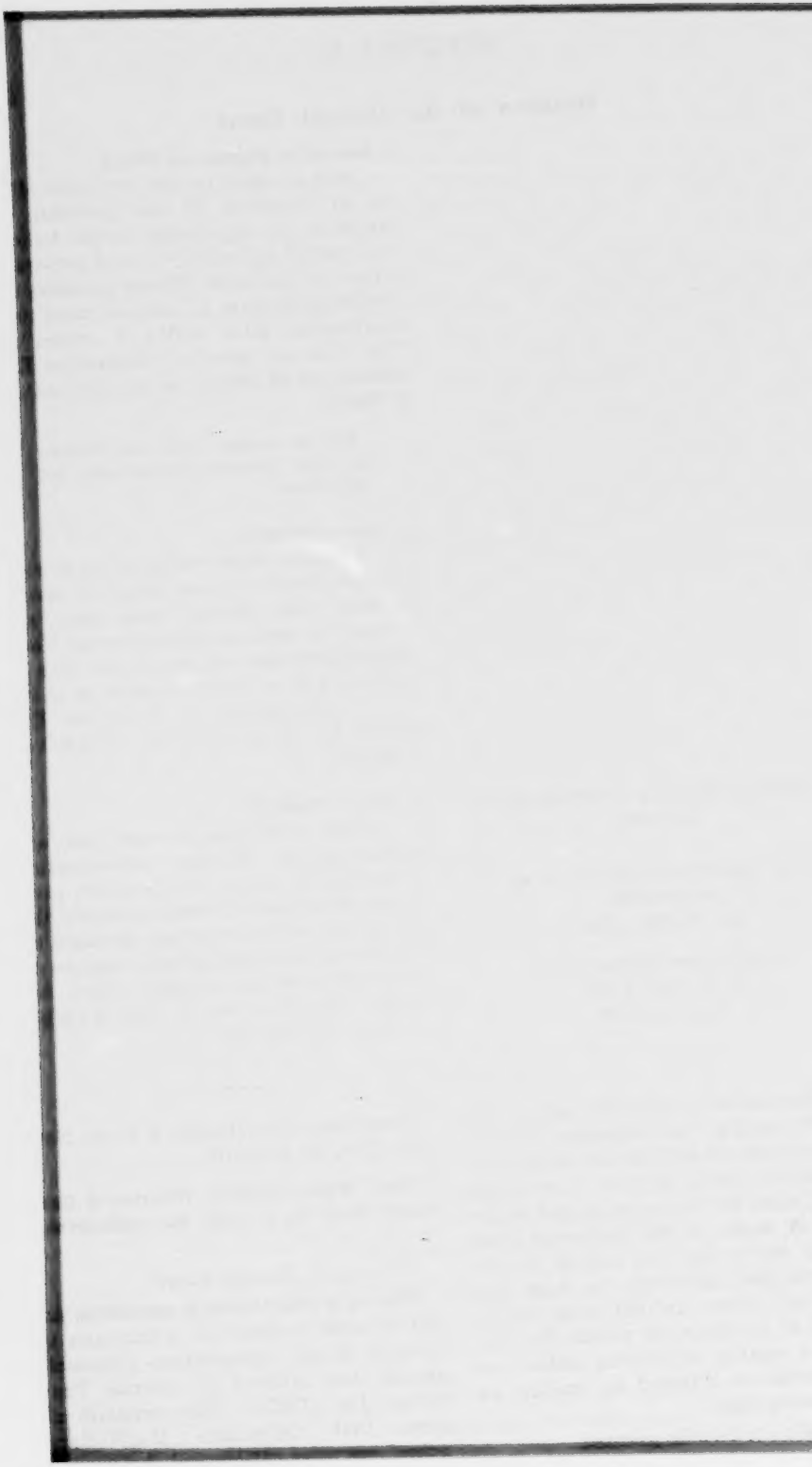


CPG's board of directors) and Brennan (CPG's senior vice president and treasurer) are liable to CPG pursuant to § 16(b) of the Securities Act of 1934, 15 U.S.C. § 78p(b) for profits realized in their short-swing sale and purchase of certain CPG securities. CPG has been joined as party defendant because of its failure to bring this action upon plaintiff's demand.

[1] Defendants MacWilliams and Brennan now move pursuant to Fed.R. Civ.P. 12(b)(6) to dismiss the complaint for failure to state a claim upon which relief can be granted. The sole issue raised by their motion is whether the transactions complained of occurred within the statutory period of "less than six months." For the reasons stated below I conclude that they did not, and the motion to dismiss will therefore be granted.

The complaint establishes the following facts for purposes of this motion:

"6. Defendant MacWilliams sold 50,000 shares of Penn Group's common stock in the open market at $63.49 per share on December 20, 1972, and purchased 45,000 shares thereof by exercising an option at $6.86 per share on June 19, 1973.

"7. Defendant Brennan sold 4,000 shares of Penn Group's common stock in the open market at $62.13 per share on December 22, 1972, and purchased 5,000 shares thereof by exercising an option at $12.00 per share on June 21, 1973."

The relevant portion of section 16(b) provides:

"(b) For the purpose of preventing the unfair use of information which may have been obtained by such beneficial owner, director, or officer by reason of his relationship to the issuer, any profit realized by him from any purchase and sale, or any sale and purchase, of any equity security of such issuer (other than an exempted security) *within any period of less than six months*, * * * shall inure to and be recoverable by the issuer, irrespective of any intention on the part of such beneficial owner, director, or officer in entering into such transaction of holding the security purchased or of not repurchasing the security sold for a period exceeding six months. * * *" (Emphasis supplied.)

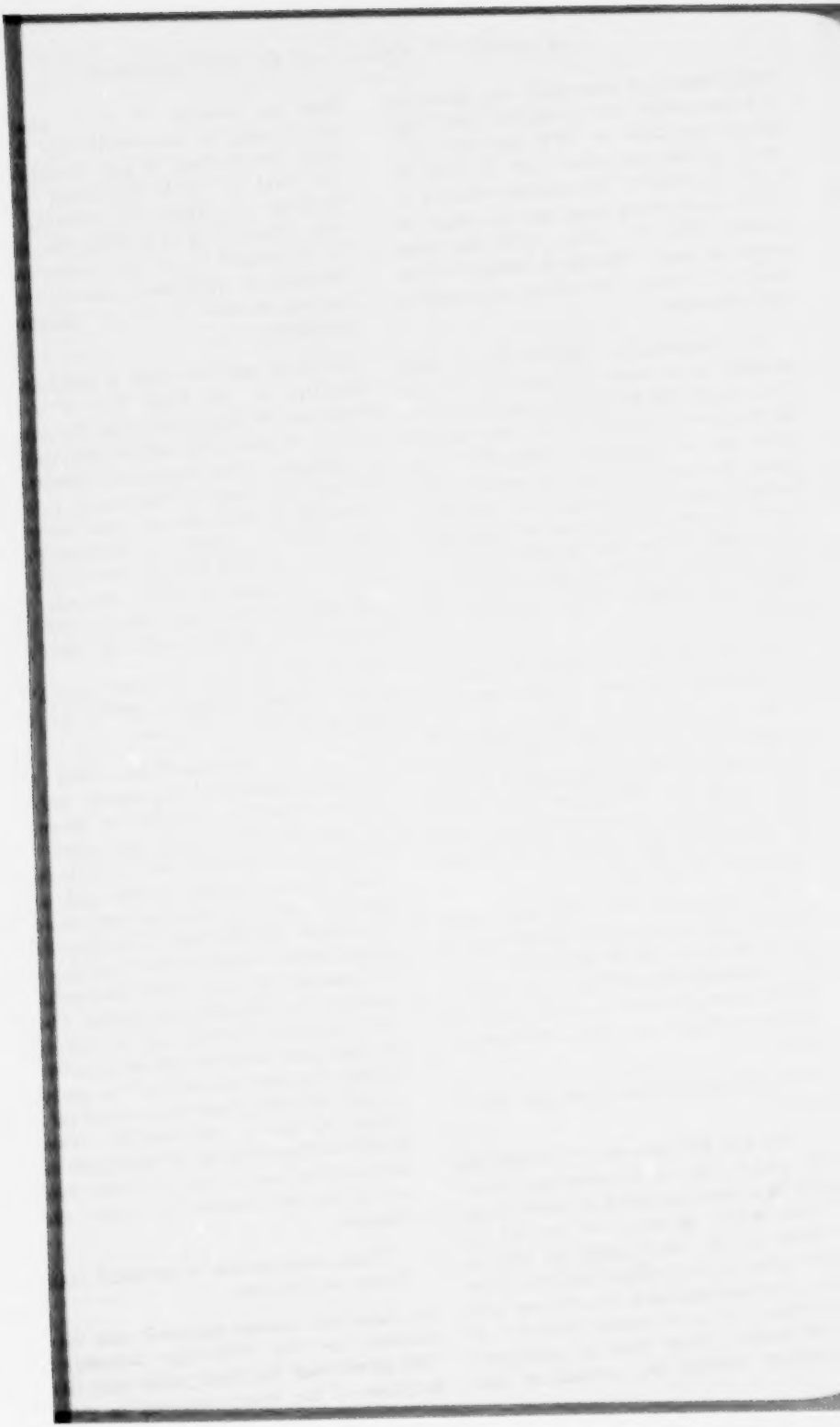
Plaintiff contends that a purchase of securities on the final day of a six-month period beginning with the date of a previous sale falls within this statutory scheme. This argument admittedly requests the court to overturn a rule established in this circuit some nineteen years ago in Stella v. Graham-Paige Motors Corp., 132 F.Supp. 100 (S.D.N.Y. 1955), remanded on other grounds, 232 F.2d 299 (2d Cir.), cert. denied, 352 U.S. 831, 77 S.Ct. 46, 1 L.Ed.2d 52 (1956).

In *Stella* the District Court interpreted the phrase "within a period of less than six months" as follows:

". . . Graham-Paige [the defendant] construes the words 'period of less than six months' to mean a period the first and last days of which each include the twenty-four hours from midnight to midnight, and the last day of which is the second day prior to the date corresponding numerically to that of the first day of the period in the sixth succeeding month. For example, the period from and including January 1st to and including June 29th would be a 'period of less than six months' but the period to and including June 30th would be a period of exactly six months. Thus profit realized from a purchase on January 1st and a sale on June 30th would not be recoverable under the statute.

"That construction is correct." 132 F.Supp. at 103–104.

The Court of Appeals approved this formulation in the following language: "We agree with the trial judge that the purchase of the stock occurred on Feb-



ruary 10, 1947, and that therefore sales made *before* August 8, 1947, were within the statutory period." 232 F.2d at 301 (Emphasis supplied).

Clearly, if this formulation is accepted here plaintiff's claim must fail, since the sale/purchase dates of both MacWilliams' and Brennan's transactions (Dec. 20/June 19 and Dec. 22/June 21, respectively) are patterned exactly after the formulation in *Stella*.

Plaintiff contends, however, that both courts were in error in that formulation because they included the initial purchase or sale date in measurement of the six-month period and because they took literally the statute's "less than" wording without giving adequate attention to the rest of the passage in which that phrase appears.

Although I might have accepted these arguments had I, rather than the Court of Appeals in *Stella*, approached this problem in the first instance, I now feel constrained by the doctrine of *stare decisis* to follow the rule established almost nineteen years ago.

[2] While plaintiff is certainly correct in asserting that *stare decisis* is not so rigid as to require perpetuation of error, I cannot agree that this is the kind of situation in which overturning an established principle is appropriate or desirable. Most importantly, the *Stella* formulation is by no means clearly in error.

Nor does the *Stella* rule suffer from any other deficiencies which might persuade me to reexamine it. On a practical basis, it has not proved unworkably difficult to apply. Further, since the six-month requirement it implements is itself an essentially arbitrary legislative guidepost, the *Stella* approach can do no significant violence to the central purpose of the securities laws.

Finally, I am unimpressed by the authorities plaintiff has assembled in support of its position. Plaintiff cites a number of passing judicial references to the § 16(b) six-month requirement which by labored inference might have some relevance, but none of which contains any indication that the courts or counsel in those cases gave direct consideration to this issue. Similarly, the analogies plaintiff attempts to draw to methods of time measurement in unrelated areas of law, in an apparent appeal to the need for uniformity in the system as a whole, are at best of minimal impact.

[3] I conclude that the central values underlying the doctrine of *stare decisis*—the interests of the legal system in consistency and uniformity—are fully applicable and dispositive of this issue. The *Stella* rule has been cited by virtually every important research source which might be consulted by a corporate insider in planning dealings in his company's securities under § 16(b), and no contrary authority has been presented.[1] Under such circumstances, absent a showing of significant unworkability or injustice, I must agree with defendants that they and other investors had a right to rely on an established rule of this circuit.

The motion to dismiss is therefore granted and the complaint dismissed. So ordered.

1. See, e. g., 15 U.S.C.A. § 78p(b) n. 56 (1971); 2 L. Loss, Securities Regulation 1058 (2d Ed. 1961) and 5 L. Loss, Securities Regulation 3021–22 (1969 Supp.); 2 CCH Fed.Sec.L.Rep. ¶¶ 26,101.012, 26,101.60 (1973); R. Jennings and H. Marsh, Securities Regulation 1307 (3d Ed. 1972). Nor, incidentally, have I been able to discover any movement by Congress or by the Securities Exchange Commission during the 19 years since *Stella* to change the effect of its rule.

Compare the approach of Judge Bonsal interpreting SEC rule 16b–6 for purposes of *calculating profits* due when improper short-swing transactions have been discovered. Morales v. Walt Disney Productions, 361 F.Supp. 1157 (S.D.N.Y.1973).

APPENDIX D

Order Extending Time to Apply for Certiorari

SUPREME COURT OF THE UNITED STATES

No. A-922

—o—

COLONIAL REALTY CORPORATION,

Petitioner,

v.

JOHN MACWILLIAMS, JR., JAMES E. BRENNAN, and COLONIAL PENN GROUP, INC.

—o—

ORDER EXTENDING TIME TO FILE PETITION FOR WRIT OF CERTIORARI

UPON CONSIDERATION of the application of counsel for petitioner,

IT IS ORDERED that the time for filing a petition for writ of certiorari in the above-entitled cause be, and the same is hereby, extended to and including July 17, 1975.

/s/ THURGOOD MARSHALL
Associate Justice of the Supreme
Court of the United States

Dated this 6th day
of June, 1975.

APPENDIX E

Statutes and Regulations

Section 16(b) of the Securities Exchange Act of 1934, 15 USC § 78p(b).

(b) For the purpose of preventing the unfair use of information which may have been obtained by such beneficial owner, director, or officer by reason of his relationship to the issuer, any profit realized by him from any purchase and sale, or any sale and purchase, of any equity security of such issuer (other than an exempted security) within any period of less than six months, unless such security was acquired in good faith in connection with a debt previously contracted, shall inure to and be recoverable by the issuer, irrespective of any intention on the part of such beneficial owner, director, or officer in entering into such transaction of holding the security purchased or of not repurchasing the security sold for a period exceeding six months. Suit to recover such profit may be instituted at law or in equity in any court of competent jurisdiction by the issuer, or by the owner of any security of the issuer in the name and in behalf of the issuer if the issuer shall fail or refuse to bring such suit within sixty days after request or shall fail diligently to prosecute the same thereafter; but no such suit shall be brought more than two years after the date such profit was realized. This subsection shall not be construed to cover any transaction where such beneficial owner was not such both at the time of the purchase and sale, or the sale and purchase, of the security involved, or any transaction or transactions which the Commission by rules and regulations may exempt as not comprehended within the purpose of this subsection.

Appendix E—Statutes and Regulations

Rule 16b-6(a) and (b) of the Securities and Exchange Commission, 17 CFR 240.16b-6(a) and (b).

EXEMPTION OF LONG TERM PROFITS INCIDENT TO SALES WITHIN SIX MONTHS OF THE EXERCISE OF AN OPTION.

(a) To the extent specified in paragraph (b) of this rule the Commission hereby exempts as not comprehended within the purposes of section 16(b) of the Act any transaction or transactions involving the purchase and sale or sale and purchase of any equity security where such purchase is pursuant to the exercise of an option or similar right either (1) acquired more than six months before its exercise, or (2) acquired pursuant to the terms of an employment contract entered into more than six months before its exercise.

(b) In respect of transactions specified in paragraph (a) the profits inuring to the issuer shall not exceed the difference between the proceeds of sale and the lowest market price of any security of the same class within six months before or after the date of sale. Nothing in this rule shall be deemed to enlarge the amount of profit which would inure to the issuer in the absence of this rule.

Rule 16a-1(e) of the Securities and Exchange Commission, 17 CFR 240.16a-1(e).

REPORTS OF DIRECTORS, OFFICERS, AND PRINCIPAL STOCKHOLDERS.

* * *

(e) Any person who has ceased to be a director or officer of an issuer which has equity securities registered pursuant to Section 12 of the Act, or who is a director or officer of an issuer at the time it ceased to have any equity

securities so registered, shall file a statement on Form 4 with respect to any change in his beneficial ownership of equity securities of such issuer which shall occur on or after the date on which he ceased to be such director or officer, or the date on which the issuer ceased to have any equity securities so registered, as the case may be, if such change shall occur within 6 months after any change in his beneficial ownership of such securities prior to such date. The statement on Form 4 shall be filed within 10 days after the end of the month in which the reported change in beneficial ownership occurs.